

COMMISSIONERS
Robert "Bob" Burns - Chairman
Boyd Dunn
Sandra D. Kennedy
Justin Olson
Lea Márquez Peterson



Matthew J. Neubert
Executive Director

ARIZONA CORPORATION COMMISSION

OPEN MEETING ITEM

DATE: DECEMBER 19, 2019

DOCKET NO.: AU-00000A-17-0379

TO ALL PARTIES:

Enclosed please find the recommendation of Chief Administrative Law Judge Jane L. Rodda. The recommendation has been filed in the form of an Order on:

ARIZONA CORPORATION COMMISSION
(ORDER CORRECTING DECISION NO. 77104, *NUNC PRO TUNC*)

Pursuant to A.A.C. R14-3-110(B), you may file exceptions to the recommendation of the Administrative Law Judge by filing an original and thirteen (13) copies of the exceptions with the Commission's Docket Control at the address listed below by **4:00** p.m. on or before:

DECEMBER 30, 2019

The enclosed is NOT an order of the Commission, but a recommendation of the Administrative Law Judge to the Commissioners. Consideration of this matter has tentatively been scheduled for the Commission's Open Meeting to be held on:

JANUARY 14 and 15, 2020

For more information, you may contact Docket Control at (602) 542-3477 or the Hearing Division at (602) 542-4250. For information about the Open Meeting, contact the Executive Director's Office at (602) 542-3931.

A handwritten signature in black ink, appearing to read "Matthew J. Neubert", followed by a horizontal line.

MATTHEW J. NEUBERT
EXECUTIVE DIRECTOR

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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

ROBERT "BOB" BURNS – Chairman
BOYD DUNN
SANDRA D. KENNEDY
JUSTIN OLSON
LEA MÁRQUEZ PETERSON

IN THE MATTER OF COMMISSION INQUIRY
INTO POSSIBLE MODIFICATION OF THE
FEDERAL INCOME TAX REFORM RATE
ADJUSTMENT.

DOCKET NO. AU-00000A-17-0379

DECISION NO. _____

**ORDER CORRECTING DECISION
NO. 77104 NUNC PRO TUNC**

Open Meeting
January 14 and 15, 2020
Phoenix, Arizona

BY THE COMMISSION:

* * * * *

Having considered the entire record herein and being fully advised in the premises, the Arizona Corporation Commission ("Commission") finds, concludes, and orders that:

FINDINGS OF FACT

1. On May 29, 2018, the Commission held a Workshop in the Matter of the Commission Inquiry into Possible Modification of the Federal Income Tax Reform Adjustment. The specific focus of the Workshop was on the Commission's treatment of the recovery of income taxes on Contributions-in-Aid-of Construction ("CIAC") and Advances-in-Aid-of-Construction ("AIAC"). At the conclusion of the Workshop, the Commission directed all interested parties to submit comments regarding this issue and the Commission's Utilities Division ("Staff") was to submit a report with its recommendations.

2. Staff filed its Report on August 2, 2018. Interested entities were given until August 15, 2018, to file comments to the Staff Report. Numerous entities filed comments in response to the Staff Report.

3. On October 3, 2018, Staff filed an Amended Staff Report and Proposed Order. The Amended Staff Report discussed five methodologies for how to treat the tax obligations associated with CIAC and AIAC. The five methods included:

Method 1 – Allow utilities to gross-up the contribution for the full tax liability.

Method 2 – Allow utilities to gross-up contributions but on a present value basis.

Method 3 – Allow utilities to self-pay and receive proper ratemaking treatment for the taxes paid and the carrying value thereon to be offset by the value of tax depreciation taken on assets received.

Method 4 – Allow for alternative funding methods.

Method 5 – Allow utilities to gross-up the contribution for the full tax liability but share the funding of the income tax liability with developers. This method would also allow rate base recognition for the taxes paid and the carrying value thereon to be offset by the value of tax depreciation taken on assets received.

4. Staff's Amended Staff Report recommended that Class A, B, and C water and wastewater utilities be authorized to adopt either the first, second or third methodologies and that Class D and E water and wastewater utilities be required to utilize the Full-Gross-up Methodology (first method).¹

5. On October 4, 2018, the Commission docketed the agenda for its October 11, 2018, Open Meeting which included Staff's Proposed Order as Regular Agenda Item No. 21.

6. On October 9, 2018, Commissioner Olson docketed six proposed amendments to Staff's Proposed Order.

7. On October 10, 2018, the Water Utilities Association of Arizona ("WUAA") filed exceptions to Staff's Proposed Order. WUAA proposed an amendment that would prohibit "larger pass-through entities" from collecting gross-up taxes from developers for any contributions but would allow Class C, D, and E utilities that are pass-through entities to collect gross-up taxes.

...

¹ Amended Staff Report at 10.

1 8. At the commencement of the October 11, 2018, Open Meeting, Chairman Forese pulled
2 Item No. 21 from the agenda.

3 9. On November 1, 2018, the Commission issued the agenda for its November 7, 2018,
4 Open Meeting which included Staff's Proposed Order as Regular Agenda Item No. 28.

5 10. On October 31, 2018, Commissioner Olson docketed Revised Proposed Amendment
6 No. 2 and Revised Proposed Amendment No. 6.

7 11. The matter was discussed at the Commission's November 7, 2018, Open Meeting. Staff
8 proposed an amendment that added clarifying language which the Commissioners adopted. The
9 Commission then discussed Commissioner Olson's Proposed Amendments Nos. 1 through 5,² passing
10 them, with Commissioner Olson's Proposed Revised Amendment No. 2 and Proposed Amendment
11 No. 5 being passed as verbally amended by motions of Chairman Forese. The Forese verbal
12 amendments to the Olson Amendments reclassified accounting treatment available to Class C utilities
13 from that available to Class A and B utilities to that available to Class D and E utilities. Staff's Proposed
14 Order as amended was passed by a 5-0 vote of the Commission. In addition, at the November 7, 2018,
15 Open Meeting, the Commission discussed Commissioner Olson's Revised Proposed Amendment No.
16 6, ultimately taking no action on Amendment No. 6 and determining to discuss it at a future Open
17 Meeting.

18 12. Comments from WUAA concerning the gross-up of taxes for pass-through Class C, D,
19 and E utilities were docketed on November 19, 2018.

20 13. The Commission issued Decision No. 76974 on November 27, 2018, to reflect the
21 Commission's actions taken at the November 7, 2018, Open Meeting. However, Decision No. 76974
22 did not reflect the Forese verbal amendments to the Olson Amendments.

23 ² Olson Amendment No. 1 replaced Staff's method 5 with a new "Gross Up Sharing Method". Olson Revised Amendment
24 No. 2 clarified that it refers to water and wastewater utilities and removed the full gross up method option for Class A, B,
25 and C water and wastewater utilities. Olson Amendment No. 3 recognized that proper ratemaking treatment for a utility
26 using the self-pay method depends on whether the utility uses its own funds to pay the tax as opposed to using a portion of
27 a contribution to pay the tax. Olson Amendment No. 4 clarified that pass-through entities that are owned by a "C"
28 corporation that would recognize corporate tax expense from any contribution received can recover tax expense according
to the methods allowed in the policy being adopted. Olson Amendment No. 5 required Class A, B, and C utilities to self-
pay the taxes associated with hook-up contributions by using a portion of the existing hook-up fee fund and provided the
option of using either the Self-Pay or Gross-Up Sharing Methods for paying taxes associated with other contributions and
advances in aid of construction. Olson Revised Amendment No. 6 prohibited a utility from requiring a developer to gross-
up a contribution for tax expense if the utility is not expected to incur tax expense as a result of the contribution.

1 14. On December 11, 2018, Commissioner Olson docketed a Second Revised Olson
2 Proposed Amendment No. 6, which would prohibit a utility from requiring a developer to gross-up a
3 contribution for tax expense if, as a result of the contribution, the utility is not expected to incur
4 incremental current tax expense or to reduce a deferred tax asset for a carryforward.

5 15. Also on December 11, 2018, Staff filed a Motion to Amend Decision No. 76974 *Nunc*
6 *Pro Tunc* ("First Motion NPT"). The First Motion NPT noted that Decision No. 76974 did not reflect
7 the Forese verbal amendments to the Olson Amendments and that Decision No. 76974 should have
8 provided that all Class C, D, and E utilities shall use the full gross-up methodology. As an Exhibit to
9 the First Motion NPT, Staff attached a new form of Order which purported to reflect a corrected version
10 of the Order approved at the November 7, 2018, Open Meeting, and was intended to replace Decision
11 No. 76974 in its entirety.

12 16. On December 12, 2018, WUAA docketed a letter with an attached revised amendment
13 that would allow gross-up of income taxes on CIAC and AIAC for pass-through Class C, D, and E
14 utilities. WUAA's attached proposed amendment became known as "WUAA's Proposed Amendment
15 No. 2."

16 17. Also on December 12, 2018, the Commission docketed the agenda for its December 17-
17 18, 2018, Open Meeting, which included Regular Agenda Items 37 and 38 related to this docket. Item
18 No. 37 was a proposed *Nunc Pro Tunc* Order amending Decision No. 76974. Agenda Item No. 38 was
19 noticed to consider two additional amendments to Decision No. 76974 comprised of Commissioner
20 Olson's proposed Amendment No. 6 and a proposed December 12, 2018, Revised Amendment
21 submitted by WUAA. A revised Open Meeting Notice docketed on December 13, 2018, reflected that
22 Agenda Items No. 37 and 38 had been pulled.

23 18. On January 7, 2019, Farmers Water Company ("FWC") docketed a request that Agenda
24 Items Nos. 37 and 38 from the December 12, 2018, Open Meeting be placed on the Commission's
25 January 15, 2019, Open Meeting agenda.

26 19. On January 9, 2019, the notice of the Commission's January 15-16, 2019, Open Meeting
27 included Agenda Items Nos. 14 and 15, to amend Decision No. 76974 *nunc pro tunc* and to consider
28 Olson Amendment No 6, respectively. The items were pulled from discussion on the first day of the

1 Open Meeting, January 15, 2019. Agenda Item No. 14, relating to the *nunc pro tunc* correction of
2 Decision No. 76974, was subsequently addressed and passed on the second day of Open Meeting,
3 January 16, 2019.

4 20. On January 22, 2019, FWC filed "Supplemental Interim Open Meeting Comments"
5 expanding on its position regarding allowing Class C pass-through entities to be treated on par with
6 Class D and E pass-through entities with respect to the gross-up of income taxes on CIAC and AIAC.

7 21. On January 30, 2019, this matter was placed on the agenda for the Commission's
8 February 5-6, 2019, Open Meeting as Regular Agenda Item No. 23, with notice that discussion would
9 consider a "Motion to Reopen Decision No. 76974 Pursuant to A.R.S. §40-252 for Consideration of
10 Commission Olson's Amendment No. 6 and the Water Utility Association of Arizona's Proposed
11 Amendment No. 2."

12 22. At the Commission's February 5, 2019, Open Meeting, the Commission discussed the
13 issues raised by the Second Revised Olson Proposed Amendment No. 6 and the WUAA Revised
14 Proposed Amendment No. 2 and, on the second day of Open Meeting, February 6, 2019, voted to adopt
15 the Second Revised Olson Amendment No. 6. The Commission did not take action on WUAA's
16 Revised Proposed Amendment No. 2.

17 23. On February 20, 2019, the Commission issued Decision No. 77084 to correct Decision
18 No. 76974, *Nunc Pro Tunc*, ostensibly to add the Forese verbal amendments passed at the November
19 7, 2018, Open Meeting and to include the Second Revised Olson Amendment No. 6 adopted on
20 February 6, 2019. However, as issued, Decision No. 77084 did not reflect the Forese verbal
21 amendments.³

22 24. On February 28, 2019, the Commission issued Decision No. 77104. Decision No.
23 77104 was intended to correct Decision No. 77084 with respect to the Forese verbal amendments.
24 However, although Decision No. 77104 included the Forese verbal amendments, it dropped the Second
25 Revised Olson Amendment No. 6 that the Commission had adopted on February 6, 2019.

26 ...

28 ³ Decision No. 77084 included the Second Revised Olson Amendment No. 6 as Findings of Fact No. 15.c at page 7, line 1.

1 25. On March 6, 2019, the Commission issued a Notice of its March 12-13, 2019, Open
2 Meeting. On March 11, 2019, the Commission issued a Revised Notice of the March 12-13, 2019,
3 Open Meeting. Item No. 26 on the Agenda was the Motion to Reopen Decision No. 76974 pursuant to
4 A.R.S. § 40-252 for Consideration of the WUAA Revised Proposed Amendment No. 2.

5 26. On March 8, 2019, WUAA filed a Second Revised WUAA Amendment.

6 27. At the March 12, 2019, Open Meeting, the Commission discussed the Second Revised
7 WUAA Amendment but did not take action on the proposal.

8 28. On September 4, 2019, Commissioner Olson docketed a letter noting that Decision Nos.
9 77084 and 77104 failed to accurately reflect the Commission's actions taken at its January and
10 February 2019 Open Meetings. Commissioner Olson requested that Decision No. 77104 be corrected
11 to clear up any confusion.

12 29. On October 15, 2019, Staff filed a Motion to Amend Decision No. 77104 *nunc pro tunc*
13 ("Second Motion NPT") to reinsert the language from Commissioner Olson's Second Revised
14 Amendment No. 6. In its Second Motion NPT, Staff states that on December 11, 2018, Staff filed a
15 motion to amend Decision No. 76974 *nunc pro tunc* to incorporate verbal amendments by then-
16 Chairman Tom Forese, which were inadvertently omitted from that Decision. Staff states that Chairman
17 Forese's verbal amendments were ultimately reflected in Decision No. 77104, but that Commissioner
18 Olson's Amendment No. 6 was inadvertently omitted or dropped from that Order.

19 30. Staff requested that Decision No. 77104 be amended as follows to correct the clerical
20 errors:

- 21 a. Insert, and number as paragraph 16, the entirety of what is now paragraph 15.e
22 which appears at page 17, lines 1-17 in Decision No. 77084.
- 23 b. Renumber paragraph 16, "Gross up Sharing Method," as paragraph no. 17.
- 24 c. Beginning with the words "AIAC are defined," which appear on page 7, line 23
25 of Decision No. 77104, begin a new numbered paragraph, 18, ending at the
26 language on page 8, line 12, of Decision No. 77104.
- 27 d. Renumber, as paragraph 18, what is now paragraph 17, which begins at page 8,
28 line 13, of Decision No. 77104. Renumber all remaining numbered paragraphs in

the Findings of Fact.⁴

31. In addition to the clerical errors noted in the Second Motion NPT, the first ordering paragraph of Decision No. 77104 commencing on Page 11, line 26 conflicts with the ordering paragraph on page 12, commencing at line 15. The first ordering paragraph provides:

IT IS THEREFORE ORDERED that all ACC regulated Class A and B water and wastewater utilities shall have the option of choosing between the Self-pay Method or the Gross Up Sharing Method for the treatment of contributions and advances in aid of construction, and hook-up fees.

The ordering paragraph that commences on page 12, line 15 of Decision No. 77104 provides:

IT IS FURTHER ORDERED that all Class A and B utilities shall self-pay the taxes associated with hook-up fee contributions by using a portion of the hook-up fee contributions received. Class A and B utilities will have the option of either self-pay or the gross up sharing method for paying the tax associated with other contributions and advances in aid of construction.”

32. The same conflict in ordering paragraphs is found in Decision Nos. 76974 and 77084.

33. Commissioner Olson’s Amendment No. 5, as verbally amended by Commissioner Forese, which was adopted on November 7, 2018, amended the Proposed Order at page 9, lines 20-24 as follows:

We do not accept Staff’s recommendation that would require a utility to use the same method on hook-up fees and other contributions and advances. All Class A and B utilities shall be required to self-pay the taxes associated with hook-up fee contributions by using a portion of the hook-up fee contributions received. Class A and B utilities will have the option of either self-pay or the gross up sharing method for paying the tax associated with other contributions and advances in aid of construction. However, once the utility has made a selection regarding the payment of taxes for other contributions and advances in aid of construction, the utility must consistently follow that methodology for all its ACC regulated divisions and affiliates through the state. Class C, D and E water and wastewater utilities shall use the full gross up methodology.

It further amended the Proposed Order at page 11, by deleting lines 10-11 and replacing them with the following:

IT IS FURTHER ORDERED that all Class A and B utilities shall self-pay the taxes associated with hook-up fee contributions by using a portion of the hook up fee contributions received. Class A and B utilities will have the option of either self-pay or the gross up sharing method for paying the tax associated with other contributions and advances in aid of construction.

⁴ Staff must mean to renumber the existing paragraph 17 as paragraph 19 based on its request in item c above.

However, once the utility has made a selection regarding the payment of taxes for other contributions and advances in aid of construction, the utility must consistently follow that methodology for all its ACC regulated divisions and affiliates through the state.”

34. Commissioner Olson’s Amendment No. 5, as verbally amended, is reflected correctly on page 10, lines 18-26 of Decision No. 77104. However, the words “and hook-up fees” at page 11, line 28, should have been deleted as a conforming change when Olson Amendment No 5, as verbally amended, was subsequently passed. The intent of the Commission (as reflected in Olson Amendment No. 5, as verbally amended) is that Class A and B utilities shall self-pay the taxes associated with hook-up fee contributions by using a portion of the hook-up fee contributions received. Thus, in addition to the corrections noted by Staff in the Second Motion NPT, Decision No. 77104 should be corrected by deleting “and hook-up fees” on page 11, line 28.

35. Based on the entirety of the record, it is necessary to correct Decision No. 77104 to reflect the will of the Commission as expressed in their votes at the Open Meetings as set forth herein.

CONCLUSIONS OF LAW

1. The entities subject to this decision are public service corporations as defined in Article XV, Section 2 of the Arizona Constitution.

2. The Commission has jurisdiction over the public service corporations and the subject matter of this filing.

3. It is in the public interest to correct Decision No. 77104 to reflect the votes of the Commission in its regularly scheduled Open Meetings on November 7, 2018; January 16, 2019; and February 5, 2019.

ORDER

IT IS THEREFORE ORDERED that Decision No. 77104 is hereby corrected, *nunc pro tunc*, as follows:

Page 7, line 1:

a. Insert, and number as Findings of Fact No. 16, the following:

“A utility that does not expect to recognize an increase in current tax expense or a decrease in a deferred tax asset for a carryforward according to generally accepted accounting principles (GAAP) as a result of a contribution cannot

1 require a developer to gross-up such contribution for tax expense. A utility with
 2 a carryforward that is required under GAAP to establish or maintain a valuation
 3 allowance to offset the related deferred tax asset cannot require a developer to
 4 gross-up an adjustment to the valuation allowance. Any utility that requires a
 5 developer to gross-up a contribution for tax expense must provide a certification
 6 in the utility's Annual Report to the Commission that the utility incurred or is
 7 expected to incur a net increase in current income tax expense or a decrease in
 8 deferred tax asset for a carryforward according to GAAP in an amount equal to
 9 or greater than the amount of the required gross-up paid by developers in the
 10 period covered by the Annual Report. Upon request by the Commission Staff,
 11 the company shall provide financial statements and support demonstrating this
 12 increase in current tax expense or decrease in deferred tax asset. Provided
 13 documentation will be subject to confidentially agreements where deemed
 14 appropriate by Commission Staff."

15 Page 7, line 1:

16 Renumber Findings of Fact No. 16, "Gross up Sharing Method," as Findings
 17 of Fact No. 17.

18 Page 7, line 23 – Page 8, line 12:

19 Beginning with the words "AIAC are defined," create a new numbered
 20 Findings of Fact No. 18.

21 Page 8, line 13

22 Renumber Findings of Fact No. 17 as Findings of Fact No. 19, and renumber
 23 all Findings of Fact thereafter.

24 Page 11, line 28:

25 DELETE ", and hook-up fees"

26 ...

27 ...

28 ...

1 IT IS FURTHER ORDERED that Decision No. 77104, as corrected herein, supersedes
2 Decision Nos. 76974 and 77084.

3 IT IS FURTHER ORDERED that this Decision shall become effective immediately.

4 BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

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7 CHAIRMAN BURNS COMMISSIONER DUNN COMMISSIONER KENNEDY

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9 COMMISSIONER OLSON COMMISSIONER MÁRQUEZ PETERSON

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11 IN WITNESS WHEREOF, I, MATTHEW J. NEUBERT,
12 Executive Director of the Arizona Corporation Commission,
13 have hereunto set my hand and caused the official seal of the
14 Commission to be affixed at the Capitol, in the City of Phoenix,
15 this _____ day of _____ 2020.

16 MATTHEW J. NEUBERT
17 EXECUTIVE DIRECTOR

18 DISSENT _____

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20 DISSENT _____

21 JLR/ec
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